

DRAFT REPORT OF SUBCOMMITTEE #3, December 11, 2006

PILOT Program:

PILOTs are voluntary or negotiated payments made by tax-exempt organizations. While the Dover Amendment prevents Newton from having the political leverage of Boston and Cambridge, which are exempt from this law and receive significant PILOTs, we believe that the tax exempt properties, notably the colleges and universities, should contribute significantly more than they now do. Boston College pays Newton just \$100,000 per year and other Newton Colleges, including Mount Ida and LaSalle, make no contributions.

Newton's tax-exempt entities own properties with an assessed value exceeding \$1 billion. However, after excluding properties owned by governmental entities (city, state, federal), religious institutions and the Newton Housing Authority, the assessed value of the remaining properties is \$723,894,300. Based on recent data provided by Elizabeth Dromey, Director of Assessment Administration, if all these tax-exempt properties were taxed at the appropriate residential or commercial rate these schools and charitable entities would pay \$9,717,515 in taxes (4.6% of the '07 budget) and thus reduce the tax rates (residential from 9.33-8.87 and commercial from 17.64-17.05).

These institutions directly benefit from the quality of service provided by Newton's police, fire, and public works departments and indirectly through all the services that contribute to the quality of life in the city.

We recognize that starting a significant PILOT program will be challenging for the city and these institutions. Yet the constraints placed on Newton by Proposition 2 1/2 demand that these institutions be open to a significantly greater financial contribution to Newton. These institutions directly benefit from the quality of service provided by Newton's police, fire and public works departments and indirectly through all services that contribute to the quality of life in the city.

While we do not minimize the political challenge of breaking from the historical pattern, we believe that there is an opportunity to use the city's "bully pulpit" to engage the major tax-exempt educational institutions in negotiations about a more significant contribution to the city.

RECYCLING Program

While the city has a strong recycling program, we recommend expanding recycling revenues by starting a "No Visible Recycling Campaign" and fully involving the school system in a citywide effort. While recycling was started in schools as educational programs, by 2006 recycling has become a legitimate management responsibility. An audit of the school buildings will reveal what physical resources (e.g. cleaning stations) are needed to safely recycle paper, glass, tin and plastic and the options for negotiating

with the custodial staff about this work. Current revenues from recycling in the city are about \$320,000 and there is the potential for cost savings and revenues of over two hundred thousand more through expanded school recycling and most significantly by enforcing mandates. According to Elaine Gentile, Director of Environmental Affairs, Newton could derive substantial financial advantage by reducing the amount of trash and increasing the amount of recycling. Other communities have done this successfully and we recommend that the city develop and implement a plan for Newton.

PENSIONS

As of January 1, 2006 , the City of Newton had \$253 million of actuarial assets (\$246 million market value) in its pension plan. At that date the city had an unfunded actuarial accrued liability (“UAAL”) of \$129 million. Projected out over 22 years, this totals, with interest, approximately \$313 million. This is the amount that the city must pay over time into the retirement system. The implied actuarial rate for this is 8%.

The city currently has a pension board composed of representatives of the Firefighters’ and Patrolmen’s unions and one Mayoral appointee, unconfirmed by the Board of Aldermen. The City Controller serves as an ex officio member of the board and a fifth member is selected, without confirmation, by the other four members. Segal Advisors, a pension consultant, has been employed by the board for 15 years.

For the past 10 years, the Newton plan has underperformed the Massachusetts Pension Reserves Plan (herein after referred to as PRIT) on the average by 1.43%, which on an average base of \$225 million, has cost the plan, and therefore the city, over \$30 million . In the past year alone, the underperformance has exceeded 5% for a cost of over \$12 million. Each 1% in underperformance, at present, costs the taxpayers \$2.5 million a year, increasing to more than \$8 million per year by the time full-funding is expected to be achieved during fiscal year 2028, as this is the pay-in requirement for the pension shortfall. The total underperformance exceeds \$112 million, which does not include the additional interest required to be paid due to the underperformance for an additional \$65 million, for a total in the order of \$177 million

One remedy for this situation would be to move the management of the Newton retirement plan to the PRIT plan. At \$43.5 billion, the PRIT plan has the advantage of in house full-time professional managers and the choice of the highest rated money managers to manage the assets. It is very difficult for a fund the size of Newton’s to compete, and will continue to be so. If the Newton fund does this, and only picks up another 1% in return each year, then the pension shortfall will be reduced by approximately \$65 million and be fully funded eight years earlier than presently planned by fiscal year 2020.

If the difference is the historical average of 1.43%, then a savings of more than \$82 million would result from savings in interest alone. Investment returns would be

increased by nearly \$170 million so that total fund performance would be improved by more than \$252 million, and the system will be fully funded ten years earlier than expected by fiscal year 2018.

In this day and age, almost all non-profits have investment committees comprised of money managers from either their boards of directors, communities, etc. Whatever choices the city makes, it would behoove it to cull from our very talented citizenry to get a volunteer/appointed investment committee. Although other municipalities have not done this, Newton could set the standard and bring municipal pension management into the 21st century.

Another opportunity for offloading the pension obligation is to defease it and invest the entire current amount in zero coupon bonds. This needs to be examined.

A second opportunity would be to issue pension obligation bonds.

ENERGY SAVINGS AND SUSTAINABILITY

Introduction

During the fiscal year 2007, Newton is expected to spend slightly more than \$8 million on energy: electricity – 65%; natural gas – 15%; heating oil – 20%. By the end of fiscal year 2012, the yearly energy budget is expected to exceed \$10.5 million. Budgetary savings in excess of 20% of these amounts is believed to be easily achievable.

In addition to saving the City money on energy bills, The Newton Citizens Commission on Energy has identified these qualitative goals:

- o To better care for our local environment,
- o To protect public health,
- o To use resources wisely and efficiently,
- o To plan ahead to continued growth and consumption needs.

The United States Conference of Mayors earlier this year established the ambitious objective of zero greenhouse emissions within 20 years from now and mayors representing nearly 50 million American citizens have already agreed to pursue this goal.

Newton has the opportunity to demonstrate leadership while working toward the

achieving of all of the above goals: budgetary savings, enhanced quality of life for Newton residents with an improved environment, and reduction in CO2 and other greenhouse gases.

Discussion and Recommendations

In his November 20, 2006 State of the City Address, Mayor David Cohen reminded us that “Of our 15 elementary school buildings in Newton, the youngest turns 40 next year. Thirteen are over a half-century old, and seven have undergone no major upgrades since the 1950's. The School Department has allocated \$250,000 for a capital needs study, the first step in a process that will bring all of our schools up to modern standards.” He then went on to say: “...I am pleased to announce that I have taken the first step in the process of reinvigorating our entire public building stock. In this year's Capital Improvement Plan..., I've requested \$250,000 from the Board of Aldermen for a capital needs study of our 25 largest municipal sites. This study is the first step toward creating a priority list for bringing the interior systems and exterior conditions of our city buildings up to code, energy efficient, and safe.”

The above necessary first steps to restoring Newton's municipal building stock should be complemented by energy audits in order to identify as many opportunities for improvement in energy use efficiency and sustainability, the “priority list” referred to by the Mayor. After being identified, these opportunities should be prioritized and evaluated by the use of standard life cycle costing, so that “first cost” of any project is not determinative.

After the priority list of projects has been determined, financing options would need to be considered. As was noted in the May 2005 report of the Newton Finance and Management Working Group, chaired by Alderman Ken Parker, those options were, and remain, principally “...municipal bonding and performance contracting [Energy Services Company], in which a private entity finances design and implementation for a portion of the savings achieved.” Of the two options noted, the Newton Finance and Management Working Group found “...municipal bonding to be preferable, since interest rates are lower, control is maintained locally, and more of the savings accrues to the City...”. The 15% to 25% of project cost awarded to an Energy Services Company (“ESCO”) is in addition to the project cost and represents a variable amount of total energy savings achievable by the City. This high cost must be viewed in light of services provided by the ESCO and guaranteed savings. It must also be viewed in light of the practical outcome that the projects producing the largest savings and accordingly highest ROI's and shortest paybacks will be the most likely projects undertaken, leaving many other worthwhile projects not undertaken for want of sufficiently high early cost savings.

Savings resulting from the above process may initially provide all or at least a portion of project debt service and will ultimately enhance the City's operating budget.

POTENTIAL REVENUE ENHANCEMENT IDEAS

Revenue from Commercial Property:

The City receives property revenue from two sources: 1) property taxes, and 2) taxes on new growth construction. During the past 20 years, there has been a dramatic increase in the percentage of property taxes that are derived from residential properties (73% in 1986 to 83% in 2005), and a corresponding decrease in the amount derived from industrial and commercial properties. This rise is primarily attributable to the faster rise in residential property values than that of commercial values. However, New Growth revenues have also moved almost entirely to residential construction (86% in 2006, compared to 49% in 2001 or 55% in 1992), with very little new commercial construction during 2005 or 2006. And Newton's New Growth revenues per capita at \$26 in 2005 are the lowest of nine surveyed neighboring towns, and one-fifth of the New Growth seen in Cambridge – a city with vibrant new development. Traditionally Newton has held a healthy balance in its residential/commercial split, with less commercial property than Cambridge and Waltham, but far more than the further western suburbs of Lexington, Wellesley or Weston. For this reason, we wanted to examine the potential opportunities for reversing or stabilizing the trend of residential properties carrying an increasing share of the tax burden.

However, we discovered two fundamental impediments to increasing revenues from commercial properties:

- 1) a lack of available parcels that could be put together for a meaningfully-large commercial property of the size to hold an office park or a small research facility, and
- 2) current zoning laws and procedures that implicitly and explicitly discourage commercial development (specifically projects in excess of 20,000 square feet).

These issues have been examined in great depth by the Comprehensive Planning Advisory Committee, who issued a thoughtful planning advisory guide which is currently under review by the Board of Alderman. One of the conclusions of this Plan is, “while development makes an important contribution to the community's economic health, this City can't rely on building as a primary means of resolving fiscal strains.” (page 10-9) The Plan does not recommend an overhaul of the current zoning laws or procedures (to a more commonly-practiced 6-member Zoning Board charged with implementing and interpreting clearly delineated regulations). Instead, this Plan recommends incremental change, as exemplified by the Seven Early Action Efforts, including clarification of home business zoning, or preferential treatment for special permits which utilize green design.

Our discussions with developers who are active and interested in Newton indicate that there might be some opportunity to attract new development via a necessary change to antiquated zoning regulations for Mixed Use Districts (co-located residential and commercial) development. Mixed-use development is currently very popular with developers as one of the most financially-viable vehicles. (Newton's Mixed Use zoning needs to be modified to allow more reasonable density, as well as to have several

measurements – lot area per unit, FAR, yards, maximum height, and building coverage – work together reasonably, (which is currently not the case.)

However, even with necessary zoning changes, without a more comprehensive change to Newton's permitting procedure, commercial development is not likely to increase dramatically within the city. In addition, public sentiment appears unwilling to encourage commercial development (even in the most attractive transit-oriented locations such as Newton Centre) because of concerns of traffic, parking, and change to the residential fabric of the city's neighborhoods.

Therefore, we have concluded that an explicit effort to increase commercial revenue is not a viable strategy within the foreseen five-year time horizon.